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The Uruguay Round and the Nebraska Economy: Part I

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Introduction

According to a recent *Business in Nebraska* article, Nebraska ranked third among the 50 states in exports of feed grains and livestock products. Nebraskans are estimated to spend about one of every four retail dollars on imports.

Despite the importance of international trade, it is difficult for many Nebraskans to obtain information about distant events that may influence the state economy. In Geneva, Switzerland, representatives of the United States government and 125 other nations currently are bargaining about trade regulations in the so-called Uruguay Round of negotiations. The Uruguay Round commenced in Punta del Este on September 20, 1986 and is scheduled to conclude by the end of 1990.

This article summarizes the negotiations over products of particular interest to Nebraska. It also estimates the effects of hypothetical trade liberalization on Nebraska prices. These estimates are not precise forecasts, but they provide a rough benchmark by which to evaluate the actual outcome of the Uruguay Round.

Progress in the Negotiations

The aim of this and other rounds of multilateral negotiations under the auspices of the General Agreement on Tariffs and Trade (GATT) is to reduce import barriers on a reciprocal basis. In order to achieve this broad objective, the negotiators have been divided into 14 groups according to the type of barrier (tariffs, subsidies, etc.) or the type of product (textiles, services, tropical goods, etc.).

The agriculture negotiating group has been the scene of greatest disagreement at the Uruguay Round. At Punta del Este, all parties acknowledged the need "to bring more discipline and predictability to world agricultural trade by correcting and preventing restrictions and distortions including those related to structural surpluses . . ." The United States government and the European Community Commission (EC), however, have disagreed over the means to achieve this end. Thirteen countries in a loose coalition known as the Cairns group are allied with the U.S. position. These countries include such important agricultural producers as Argentina, Australia, Brazil, and Canada.

The U.S. wants elimination of all agricultural subsidies and import restrictions over ten years. The EC, on the other hand, wants a freeze at 1984 levels on government spending to support agricultural prices and some price and production controls in the short term. Afterward, the EC envisages negotiations to reduce support and protection gradually to stabilize international prices.

The dispute over agriculture almost scuttled the negotiations at the mid-term ministerial review of April 1989 in Mon-

State Economic Scoreboard

Change from same month one year ago.
See Review and Outlook on page 8 for more details.

	State	Metro+	Nonmetro
Motor Vehicle Sales (July) Constant $	-3.2%	-2.2%	-4.1%
Nonmotor Vehicle Sales (July) Constant $	-0.1%	2.4%	-2.7%
Building Activity (July) Constant $	-0.2%	-1.7%	1.8%
Employment (September)	-0.6%	-0.7%	-0.5%
Unemployment Rate* (September)	2.9%	3.0%	2.8%

+Omaha and Lincoln. *Unemployment is this month's rate, not a percent change from year ago.

treal. The U.S. swayed the EC from its threat to abandon the Uruguay Round by accepting a long-term objective of "substantial progressive reductions in agricultural support and protection."

At a July 1989 meeting, the U.S. proposed that all parties convert their agricultural quotas, variable levies, and other import restrictions to ad valorem tariffs so that protection could be measured by a common base: percent of import price. The EC opposed this plan because variable levies are an integral part of its common agricultural policy. Variable levies are like adjustable tariffs that are raised whenever the import price falls or domestic price support rises.

The EC believes that negotiators should formulate an aggregate measure of support for each party and then bargain over reductions in this measure. The EC proposal applies only to combined support for a few major commodities. The measure would be based on a benchmark international price. The U.S. objects to the EC plan.

In October 1989, the U.S. submitted a detailed proposal to the agriculture negotiating group. It called for staged reductions in price supports over ten years and elimination of export subsidies over five years. The EC called the U.S. proposal a step backward, and Japan termed it impractical. Developing countries criticized the plan's lack of special allowance for developing countries.

No one can predict the outcome of the Uruguay Round, but most observers agree that complete liberalization of agriculture prices is unlikely in the near future. Nevertheless, the forces in favor of unrestricted and unsubsidized trade are inexorable. This makes it worthwhile to consider the implications for the Nebraska economy. Complete multilateral liberalization, while unlikely, still serves as a useful benchmark by which to evaluate the compromises that may be seen in another year.

Price Effects of Liberalization

Several economists have estimated the impact of liberalization on agricultural prices. Most of them use independent estimates of supply and demand elasticities to assess the consequences of hypothetical changes in policy. The elasticities measure the responsiveness of producers and consumers, both at home and abroad, to small changes in subsidies, quotas, tariffs, and support prices. The calculations are complex, because information is dated and incomplete and relationships among commodities and countries must be considered. For instance, if both the grain and livestock sectors were liberalized, livestock producers might find their prices pulled up by higher foreign demand but pushed down by lower feed costs. Similarly, the effects depend on the number and size of the countries that liberalize. A large country such as the U.S. will have a much larger influence on international prices than a smaller one such as Canada.

Two studies that estimate the effects of the Uruguay Round on U.S. producer prices are summarized in Table 1. The producer prices in the table include market support prior to liberalization and cover major Nebraska agricultural products. The support creates a gap between producer prices and the unit values of goods in international trade (border prices). The ratios of these prices represent a common indicator of the degree of protection accorded to domestic producers. For instance, Tyers and Anderson estimate that the U.S. producer price on sugar was 20 percent higher than the price of sugar imports from 1980 to 1982; therefore, the ratio in the table is 1.20. The ratios for 1980-1982 and 1986 are based on actual price data, while the ratio for 1995 is projected. The ratios differ among products and over years because of alterations in support programs, changes in U.S. demand and supply, and variations in international prices.

The second set of estimates in Table 1 explores the impact of hypothetical liberalization on producer prices. Although both studies find that the international prices of all commodities will rise, the impact on U.S. producer prices is mixed. Both studies predict that livestock prices generally will rise, while sugar and wheat prices will fall after multilateral trade liberalization. Roningen and Dixit, however, estimate that corn and soybean prices will fall, while Tyers and Anderson estimate that coarse grain prices will rise.

Only Tyers and Anderson predict the impact of unilateral liberalization on producer prices. They show that, without exception, all U.S. prices would fall, and U.S. prices would fall more if the U.S. government acted alone. No wonder that U.S. Secretary of Agriculture Yeutter repeatedly has stated that the U.S. will not abandon its agricultural supports until other countries dismantle theirs.

Although many Nebraska farmers would be hurt by lower prices, Nebraska food processors and consumers would

Table 1
Agricultural Trade Liberalization Estimates for the United States

	Oilseed (Soybeans)	Wheat	Coarse Grains (Corn)	Ruminant Meat (Beef)	Nonruminant Meat (Pork)	Sugar
			Estimated Producer/Border Price Ratios Without Liberalization			
1980-1982	NA	1.15	1.00	1.10	1.00	1.20
1986	1.11	2.47	1.91	1.12	1.08	4.84
1995	NA	1.30	1.00	1.30	1.00	1.95
			Percent Change in Producer Prices with Multilateral Liberalization			
1980-1982	NA	-5	3	16	7	-20
1986	-7	-44	-33	7	2	-69
1995	NA	-4	3	15	-19	-38
			Percent Change in Producer Prices with Unilateral Liberalization			
1980-1982	NA	-12	-4	-7	-1	-27
1995	NA	-21	-6	-18	-2	-48

Sources: Rod Tyers and Kym Anderson, "Liberalizing OECD Agricultural Policies in the Uruguay Round: Effects on Trade and Welfare," *Journal of Agricultural Economics*, 30, no. 2 (May 1988), Table 4, p. 208 and Vernon Roningen and Praveen Dixit, "Economic Implications of Agricultural Market Reforms in Industrial Market Economies," paper presented at the International Agricultural Trade Research Consortium Symposium, "Bringing Agriculture into the GATT," Annapolis, Maryland, August 19-20, 1988

benefit from lower agricultural prices and lower government costs. The studies estimate that the consumer benefit would have been in the range of $370 to $459 per nonfarm household in terms of 1985 or 1986 expenditures. For each dollar lost by farmers, other consumers would gain $1.15 to $1.38. Clearly, these benefits as well as the benefits of trade liberalization to livestock producers also must be considered in assessing the overall impact of the Uruguay Round on the Nebraska economy.

Limitations of the Analysis

Foremost among the issues raised by these analyses of the Uruguay Round is the question of why the estimates differ. There are many possible reasons, because the analysts use different methods and sources of information. Nevertheless, the main differences appear to stem from the choice of base year; in some years international prices have been high relative to support prices, and in other years they have been low. The Tyers and Anderson analysis, for example, yields results similar to the Roningen and Dixit analysis when the same support and international price data are used. The impact of liberalization on the Nebraska economy will be sensitive to changes in U.S. support policies and in world demand and supply conditions in the near future.

The U.S. situation in 1989 differs from all the scenarios in Table 1. Drought and set-asides have pulled up many international prices, while U.S. support prices have been steady or declining slightly in recent years. Estimates of the support/international price ratios for 1989 appear in Table 2. On the basis of these ratios, the effects of liberalization on producer prices generally would be smaller than that predicted by previous research. Estimates of percentage changes in producer prices under 1989 conditions appear in Table 2.

Traditional support policies are not the only government actions that could influence the outcome. Land set-aside programs could restrict expansion of grain production that otherwise would occur if prices rose. Restructuring of centrally planned economies could enhance their agricultural production, but also could increase their demand for foreign harvests. The estimates in Tables 1 and 2 ignore these important policies.

Table 2
Agricultural Trade Liberalization Estimates for 1989

Sorghum	Soybeans	Wheat	Corn	Beef	Pork	Sugar
Estimated Producer/Border Price Ratios Without Liberalization						
0.97	0.70	1.02	1.13	1.16	1.02	2.00
Percent Change in Producer Prices with Multilateral Liberalization						
1	20	-1	-5	5	1	-35

Source: Author's estimates based on prices for the first half of 1989 reported in USDA, Economic Research Service, *Wheat Situation and Outlook* and Foreign Agricultural Service, *World Sugar and Molasses Situation and Outlook, World Oilseed Situation and Market Highlights, Export Markets for U.S. Grains and Products, and Dairy, Livestock, and Poultry: U.S. Trade and Prospects*

Despite the complexity of the economic models that have been used to generate the estimates of post-Uruguay Round price changes, they still do not consider a number of important side effects. Multilateral liberalization also would affect temperate fruits and vegetables, tropical products from less developed countries, and manufactured products. Liberalization also could cause the exchange rate to depreciate, which would stimulate all export industries and unprotected import-competing industries. Liberalization that lowered the prices of agricultural outputs would reduce the prices of inputs. Current owners of land would suffer a capital loss, for instance, but future farmers would benefit from cheaper land costs. Moreover, as the factors of production were reallocated to more efficient types of employment, national output and consumer welfare would rise considerably higher than these studies estimate.

The side effects of agricultural trade liberalization are almost all positive. First, liberalization would ensure the viability of U.S. agricultural production by mitigating the price effects. If the less developed countries abandoned their restrictions, they probably would increase their demand for U.S. meat and grains. Second, agricultural trade liberalization would provide additional benefits to consumers and nonagricultural industries. Thus, agricultural studies that ignore the side effects give an unduly pessimistic view of the overall economic impact of the Uruguay Round.

There are several technical problems in the studies. The studies assume that agricultural commodities are interchangeable. For instance, grass-fed beef from Australia is not distinguished from the grain-fed beef of the U.S. The elasticities that have been used to calculate the effects of changes in quotas, tariffs, and support prices, have been estimated statistically from historical data. To the extent that historical price changes have been relatively small and to the extent that historical producer and consumer responsiveness have been influenced by past policies, the elasticities probably would not apply to drastic changes such as complete liberalization. Finally, the studies are aggregated nationally—the studies ignore the redistributive effects of liberalization among regions of the country and among types of farms.

Epilogue and Prologue

The value of the estimates presented here does not depend on their accuracy. The limitations of price analysis and uncertainty surrounding the current negotiations in Geneva preclude accurate forecasts of the effects of multilateral trade liberalization. The analysis does provide a systematic way of thinking about the problems and opportunities that will confront the U.S. in the future. If we can develop an understanding of the economic forces shaping our destiny, we will be better prepared to meet the challenges to come. To further that end, next month's *Business in Nebraska* will use price estimates to assess the Uruguay Round's impact on broader measures of Nebraska economic activity such as personal income, retail sales, and employment.

Secondary Effects of Irrigation Under Drought Conditions

F. Charles Lamphear and Merlin W. Erickson

The October *Business in Nebraska* investigated the direct contribution of irrigation during periods of drought. The article simulated two drought scenarios for 1985 conditions: a moderate drought 20 percent below normal precipitation and a substantial drought 40 percent below normal precipitation.

The simulation study shows the prominent role irrigation plays in periods of drought. For example, the state would have lost approximately $1.2 billion in crop output if there had been no irrigation and a substantial drought in 1985.

The $1.2 billion figure represents the direct effects of irrigation on the state's economy. This article focuses on additional irrigation effects on the state's economy, called *indirect effects*.

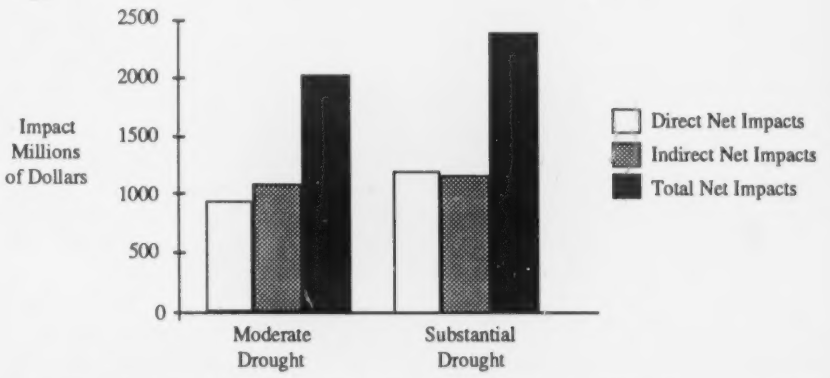
Added output due to irrigation means added business activity for manufacturing, utilities, transportation, retail and wholesale trade, insurance, and finance, to name a few. Irrigation indirectly supports hundreds of Nebraska businesses.

Irrigation's indirect effect on other businesses was measured using input-output models that identify and quantify in matrix form all the interindustry transactions that occur during an accounting period. This matrix traces the impact of one industry on other industries.

Bureau researchers construct and maintain input-output models of the state's economy. A 1985 state-based model was used in the irrigation study because the base year for the study was 1985. Special adjustments were made in the 1985 model to reflect alterations in production expenses due to the simulated drought conditions. The interindustry relationships contained in the 1985 input-output model had to be recalculated to reflect certain changes in crop production expenses due to the simulated drought conditions.

Figure 1 summarizes the direct and indirect effects of irrigation for simulated moderate and substantial drought conditions. The net direct effect for a moderate drought situation is $896.2 million. The net direct effect for a substantial drought is $1.2 billion. These are net direct effects—they represent the difference between the value of crop output from irrigation and the value of crop output under simulated dryland drought conditions for the same land base.

Figure 1
Net Economic Effects of Irrigation
for Moderate and Substantial Drought Conditions for Nebraska
1985 Prices and 1985 Irrigated Land Base



The direct effect triggered additional indirect effects that were calculated from adjusted state input-output models. Figure 1 shows net indirect effects for the moderate and substantial drought situations at approximately $1.04 billion and $1.17 billion respectively. Total net effect is the sum of direct and indirect net effects. Total net effects are approximately $1.93 billion for the moderate drought scenario and $2.38 billion for the substantial drought situation.

Table 1 presents selected industry breakdowns of the estimated $1.2 billion in net indirect economic effects for the substantial drought situation for the state.

The approximate $131 million figure reported in Table 1 for the trade sector represents this sector's mark-up on goods sold. In total retail sales, it represents approximately $1.0 billion. Other figures in Table 1 represent industry gross outputs.

Table 1
($000s)

Industry	Net Indirect Economic Impact
Manufacturing	$191,755
Transportation	$30,279
Utilities	$97,665
Trade*	$130,843
FIRE**	$120,413
Services	$143,115

* This figure represents the trade sector's margin or mark-up on goods sold
** FIRE represents finance, insurance, and real estate

Table 1 shows the distribution of effects across industries. There is also an associated geographic distribution across communities. Although such an investigation was outside the scope of this study, community level effects of irrigation and the long-term effect of irrigation on the state's economy need to be examined. The current study focused on interindustry sales and purchases related directly and indirectly to irrigation during a single accounting period. The study ignored the long-term effects of irrigation on investments and capital growth (for example, growth in the livestock and meat processing industries). Thus, the current study understates the full effect of irrigation on the state's economy. Without further study, however, it can be said that irrigation is a vital segment in the state's economy, especially in agribusiness.

A final article in the irrigation series on sustaining and maintaining an adequate supply of quality water in Nebraska will appear next month. A detailed report of the recent irrigation study is being compiled. The report is expected to be completed by the first of next year. Because copies will be limited, those interested are encouraged to contact the Bureau before the end of the year.

Banking in Nebraska: Part 2
The Savings and Loan Crisis

Andrew Pitcher

This article, the second in a series of three examining trends in Nebraska's banking industry, focuses on Nebraska savings and loans. Savings and loan institutions merit special attention because of the current crisis surrounding the industry.

S&Ls have many of the features of commercial banks, but they have evolved through different processes and have been subject to different regulations. S&Ls are insured through the Federal Savings and Loan Insurance Corporation (FSLIC). Traditionally S&Ls were bound to operate solely in the home mortgage market. Although financial market deregulation has allowed these institutions to diversify their lending activities, savings institutions still account for more than half of the residential loans outstanding in the private sector.

Although there currently exist only 24 savings and loan institutions in Nebraska, the industry operates on a scale comparable to that of commercial banks. As of December 31, 1988, Nebraska S&Ls controlled $12.305 billion in assets. Nebraska commercial banks controlled $17.471 billion over the same period.

Origins of the Crisis

The 1980s have been turbulent times for the S&L industry. It seems unlikely the industry will survive in its present form in the 1990s. The roots of S&L industry problems can be traced to deregulation in the early 1980s. Although deregulation provides a more competitive environment, the transition can create problems. This is particularly true when the economy is undergoing structural change as it was in the early 1980s.

Regulatory Changes

At the beginning of the 1980s a new regulatory environment emerged for S&Ls. The most notable regulatory changes were the gradual elimination of deposit rate ceilings and a relaxation in the restrictions on the lending and borrowing activities of S&Ls. Also, deposit insurance coverage for federally insured S&Ls was increased from $40,000 to $100,000.

The phaseout of deposit rate ceilings had significant implications for savings and loan institutions. S&Ls had enjoyed benefits from the legislated interest rate differential that existed between S&Ls and commercial banks since 1966. The imposition of interest rate ceilings resulted in S&Ls engaging in behavior that was not economically efficient. For example, S&Ls typically competed for deposits on a nonprice basis. S&Ls may have engaged in expense-preference behavior such as higher salaries and more branches. Once interest rate ceilings were removed, it was difficult for many institutions to be competitive.

Economic Environment

S&Ls were ill equipped to handle the changes in the economic environment that occurred in the early 1980s. One of the principles of good financial management is the need to balance maturities of assets and debt or to insure against the risk of interest rate fluctuations through portfolio immunization strategies. This rule is particularly relevant to the management of S&Ls. The core of a typical S&L's business is fixed rate mortgage lending. Although mortgage lending is by nature long term, an S&L's assets are primarily short-term deposits.

The early 1980s were marked by recession. The major impact of the recession on S&Ls was a rise in interest rates coupled with a dramatic decrease in housing construction. In the first six months of 1981, the industry recorded its first semiannual loss since the creation of the Federal Home Loan Bank Board in the 1930s. Combined with these operating losses was a massive drop in deposits. To offset the disintermediation resulting from high interest rates and the development of competing institutions such as money market mutual funds, regulators approved the creation of new financial instruments that would yield higher returns for depositors. The combination of a higher cost of borrowing and increased competition squeezed S&L net margins further. As their profitability declined, S&Ls had a greater incentive to take riskier lending and investments--any losses, in effect, would be underwritten by the FSLIC, whereas profits would accrue directly to the S&L. Because insurance premiums were not related to risk, risky S&Ls therefore were being subsidized by the conservatively managed institutions. Deposit insurance allowed depositors at federally insured S&Ls protection regardless of the risk of the institution's underlying loan portfolio. Risky S&Ls were not subjected to market discipline and had little incentive to restrict risky loans and investments. As many institutions found themselves overextended, profits declined. Many S&Ls were trapped in a vicious circle.

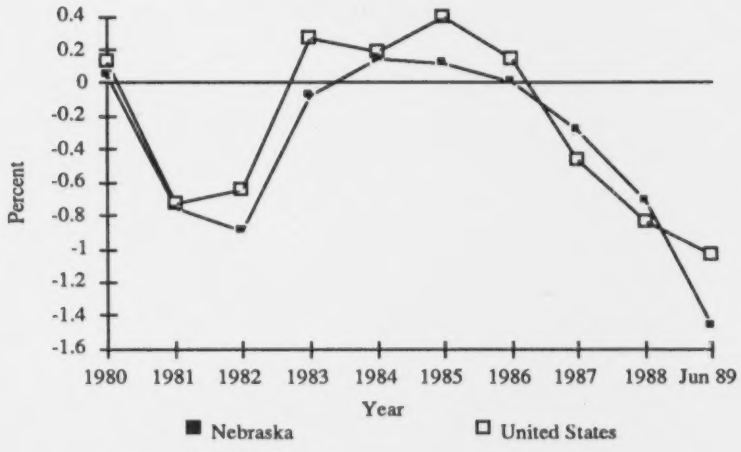
When interest rates began to decline in 1983, many industry observers believed that S&L profitability would be restored. To a certain extent, the outlook improved. Unfortunately, the industry's structural problems had not been addressed. The economic expansion in the 1980s allowed S&Ls to grow at an unprecedented rate. With the growth came virtually unrestrained investment in risky ventures. The fall in oil and commodity prices and the resultant collapse of the economies of states dependent on oil and commodity production, particularly Texas, meant that S&Ls that had overextended their lending and investment activities were driven further into insolvency. By the end of 1986, the FSLIC was technically insolvent.

Fraud

Although fraud has played a role in the S&L crisis, fraud itself is only a symptom. The structure of the industry and the way the industry was regulated allowed fraud to promulgate. The most spectacular manifestation of fraud in the industry was the acquisition of ailing S&Ls by corporations seeking to acquire a bank in order to access cheap financing. The new owners of the S&L could inflate the value of assets to back the loan and invest the proceeds in speculative ventures.

The more common incidence of fraud in the industry was more subtle and manifested itself through poor internal control mechanisms. S&L management could appropriate funds to invest in fanciful real estate ventures that lacked prudent management. The industry was expanding quickly, and managers were eager to make quick profits without doing the necessary financial analysis.

Figure 1
Return on Average Assets, Nebraska and U.S.



Source: Sheshunoff & Co.

Nebraska S&Ls

In March 1989, there were 24 savings and loan institutions operating in Nebraska. Of these, 17 were mutual institutions, owned by members and issuing no capital stock. Nebraska S&Ls are concentrated in the larger metropolitan areas, with nearly 88 percent of Nebraska S&L assets in institutions headquartered in Lincoln or Omaha. Despite the relatively few number of institutions, over 200 S&L branches are located throughout the state.

Loan Portfolio

An important determinant of the economic viability of an S&L is the quality of its loan portfolio. An institution's loan portfolio reflects management decisions on how its funds should be used. Currently, the healthier Nebraska S&Ls tend to be those with a relatively high proportion of home mortgage lending. In contrast, those institutions doing poorly are those with a relatively high proportion of nontraditional lending such as land acquisition and development and nonresidential real estate.

A measure of the quality of an institution's loans is indicated by the number of foreclosures it makes. Mortgage foreclosures by Nebraska S&Ls have increased approximately tenfold from 1978 to 1987. In 1978 U.S. and Nebraska foreclosure rates were nearly equal, about half a percent of total mortgages. In 1987 Nebraska S&Ls made 1,248 mortgage forecloses, representing 1.12 percent of the total number of mortgages. The comparable figure for the United States was 0.74 percent. Furthermore, loan quality is inversely related to capital adequacy, with those institutions suffering from an erosion of capital having poor quality loan portfolios. As of June 30, 1989, repossessed and other real estate assets as a proportion of total asset for Nebraska S&Ls averaged 4.5 percent. For those S&Ls with a positive tangible capital-to-total asset ratio, the proportion averaged only 1.1 percent. In contrast, those S&Ls with a negative tangible capital-to-total asset ratio had a repossessed asset ratio of 8.6 percent.

Profitability

For 1988, federally insured Nebraska S&Ls yielded, on average, -0.71 percent return on average assets (ROA). Although this return was not as low as the national average for the year (-0.84 percent), it represents continuing decline in S&L profitability in Nebraska. The results for the six months ended June 1989 show further deterioration in the profitability of Nebraska S&Ls. The Nebraska average annualized ROA of -1.46 percent exceeds the national figure of -1.03 percent. Figure 1 shows the ROA for Nebraska S&Ls over the period 1980 to June 1989.

It is clear from Figure 1 that Nebraska S&L profitability is closely linked with national trends. The severe downturn in ROA at the beginning of the decade resulted from the regulatory and structural changes mentioned above. By the mid-1980s, the crisis had been averted by several factors. These included the sale or merger of some of the unprofitable institutions, less volatile interest rates, and a period of sustained economic growth. This respite was only temporary, however, as no measures had been taken to address the fundamental weakness of the S&L industry. To examine the factors that led to the deterioration in the economic viability of S&Ls, it is necessary analyze the net interest margin and capital adequacy.

Net Interest Margin

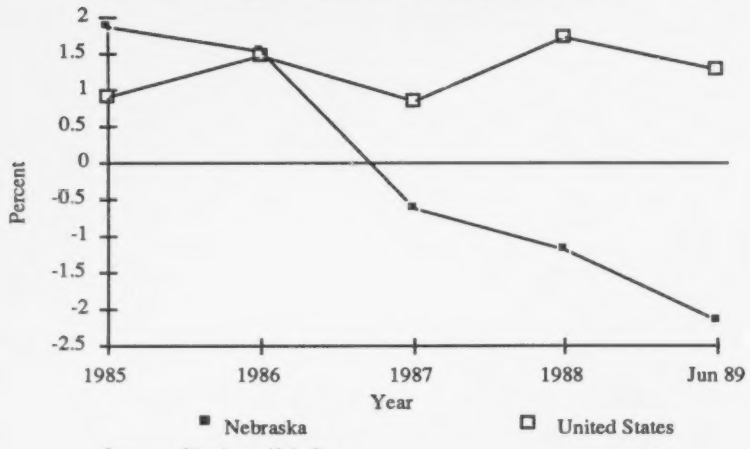
The net interest margin (NIM) is a measure of the extent to which interest income covers interest expense. The higher the net interest margin, the more profitable is the bank's ability to earn income on its loans versus the cost of the funds it borrows from depositors.

Although the net interest margin improved for Nebraska S&Ls between 1984 and 1986, it fell in 1988 as interest expenses rose faster than interest income. The spread probably narrowed because of the general rise in interest rates during 1988. The interest rate rise forced S&Ls to pay higher interest on their deposits; otherwise customers would deposit their funds elsewhere. Interest income did not rise to the same extent, as the main customers of S&Ls are holders of mortgages. S&Ls are unable to increase interest charges quickly. Of the 24 Nebraska S&Ls operating as of June 1989, four experienced a negative net interest margin. That is, their cost of funds exceeded their interest expense, even before operating income was charged.

Capital Adequacy

One of the most significant features of the S&L crisis has been the failure of S&Ls to retain sufficient capital to protect depositors from possible financial difficulties. Deposit insurance provides an incentive to keep capital as low as possible to increase financial leverage (the ability to expand the level of operations through borrowing). The capital adequacy of S&Ls can be measured by the net worth-to-total assets ratio. Unfortunately, the net worth reported by S&Ls is their regulatory net worth. Regulatory net worth disguises an institution's real net worth. Regulatory net worth includes such accounting fictions as net worth certificates (paper issued by the Federal Home Loan Bank Board to increase recorded net worth), appraised equity capital, qualifying subordinated debentures, and deferred losses

Figure 2
Tangible Capital as a Percentage of Assets



Source: Sheshunoff & Co.

on assets that bear below market interest rates.

A better measure of the value of economic net worth is tangible net worth. This measure excludes good will and other intangible assets. Figure 2 shows the ratio of tangible capital to total assets for Nebraska and United States S&Ls in aggregate over the period 1985 to June 1989.

For the first six months of 1989 Nebraska S&Ls had, in aggregate, a ratio of tangible capital to total assets of -2.15 percent. If all Nebraska's S&L were grouped together, the resulting entity would be insolvent (having more liabilities than assets). In contrast, United States S&Ls had, in aggregate, a low, but positive tangible capital-to-total assets ratio.

A closer examination of latest financial results (the six months ending June 1989) for Nebraska S&Ls reveals considerable variation in capital adequacy. In terms of regulatory capital, five of Nebraska's 24 S&Ls had a capital-to-asset ratio of less than zero. When capital is adjusted to the tangible capital definition, 11 S&Ls (or 46 percent) had a negative capital ratio. The lowest tangible capital-to-assets ratio was nearly -62 percent, with the highest at +16 percent. Approximately half the Nebraska S&Ls had a tangible capital to assets ratio between -5 percent to -3 percent.

The S&L Bailout

The Financial Institutions Reform, Recovery, and Enforcement Act (1989) provides some sweeping changes to the S&L industry. Under the S&L bailout plan, it will cost about $166 billion over the next ten years to restructure the nation's savings and loan industry. The bailout will be jointly financed by the taxpayer and the industry, with the taxpayer contributing about three-quarters of the cost. It is the job of a new bureau within the Treasury known as the Office of Thrift Supervision to bring the insolvent S&Ls' tangible capital to zero through a $50 billion cash infusion to the industry. Additional capital must be raised through investors. It will be the job of the FDIC through a new federal agency known as the Resolution Trust Corporation to dispose of the assets of acquired S&Ls.

The key provisions of the Financial Institutions Reform, Recovery, and Enforcement Act (1989) are:

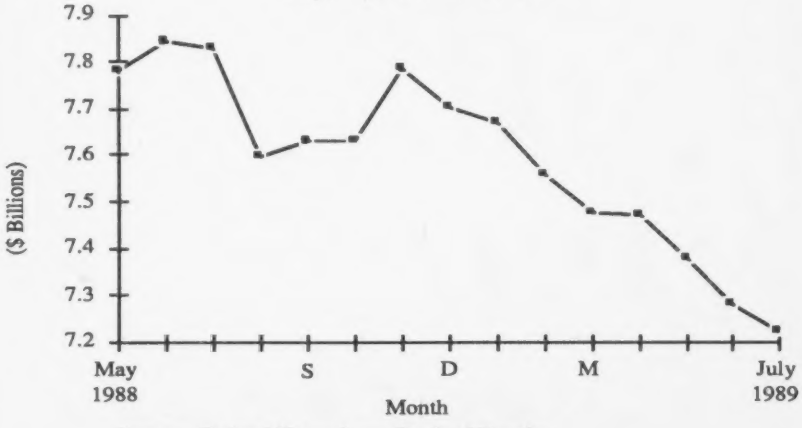
Creation of the Savings Associations Insurance Fund (SAIC) to replace the FSLIC, to be administered by the FDIC

* Abolition of the FSLIC and the Federal Home Loan Bank Board
* Increased insurance premiums from $2.03 per $1000 of deposits to $2.30 per $1000 of deposits by 1991
* Restrictions on purchases of junk bonds
* Require core capital of not less than 3 percent of total assets
* Tangible capital requirement of not less than 1.5 percent of total assets
* Savings institutions must hold at least 70 percent of portfolio assets in mortgage-related investments
* Certain defined investments may not exceed 15 percent of assets
* Easing of bank holding company restrictions
* The Federal Home Loan Banks will be required to make significant annual contributions to the new affordable housing program.

Implications for Nebraska S&Ls

Figure 3 shows the level of deposits at Nebraska S&Ls over recent months. Although part of the decline may be attributable to interest rates that were rising through the spring, it is likely that deposits at Nebraska S&Ls have dropped steadily throughout the current year due to depositor uncertainty about the S&L bailout. The decline in deposits may exacerbate the industry's financial condition if holdings of mortgages and mortgage-backed securities also fall at a similar rate. More recently, S&Ls have engaged in a deliber-

Figure 3
Deposits of Nebraska S&Ls



Source: Federal Home Loan Bank of Topeka

ate strategy to shed assets in order to meet the new capital requirements.

The area where the new regulations will have the greatest impact for Nebraska S&Ls is the new capital requirements. Using the results for the six months ended June 1989, only half of the Nebraska S&Ls currently would meet the requirement of a net tangible to asset ratio of 1.5 percent.

The impact of other provisions of the act are more difficult to discern. For example, the increased freedom for bank holding companies to acquire healthy savings institutions and merge their operations into the bank's may provide increased competitive opportunities for Nebraska banking institutions.

Conclusions

Although many necessary steps are being taken to help the S&L industry overcome its difficulties, lingering problems remain. First, the issue of deposit insurance needs to be addressed. Part of the S&L problem was that deposit insurance rates were not tied to the riskiness of an institution's loan portfolio. This means that risky S&Ls were subsidized at the expense of conservatively managed institutions. The new capital standards that are based partly on an institution's asset quality will alleviate this problem. By tying deposit insurance rates with portfolio risk, however, there will be an incentive for risky institutions to reduce their level of risk. Second, there is a need to develop a more coordinated approach to banking deregulation in the future. Institutions that operate in the same markets should be governed by the same regulations. Finally, the restructuring of the S&L industry needs to be handled carefully. S&L assets should be sold in a manner that minimizes any instability to the healthy side of the industry.

Given the current state of the S&L industry, it is inevitable that there will be more S&L closures in the state. After this period of consolidation, a more robust industry should emerge. In the future, it is likely that successful S&Ls will concentrate more on the home mortgage market where many benefit from a competitive advantage.

Review and Outlook

John S. Austin

National Economy

This month marks the start of the eighth year of continued economic expansion. The advance report for third quarter GNP shows a real increase of 2.5 percent at annual rates. That increase was slightly larger than expected. The GNP numbers will be revised in the near future, but major growth areas can be identified.

A major contributor to the jump in GNP was personal consumption, specifically durable goods. Durable goods advanced 15.0 percent, due in large part to fast paced third quarter auto sales. These auto sales were stimulated by large discounts from the factories and advance notice of large list price increases for the 1990 model year vehicles.

Investments in producer structures and durable equipment gained over 5.0 percent at annual rates in the third quarter. Residential investment decreased 4.8 percent.

The government block dropped 2.3 percent. All of the fall was attributed to the federal government. State and local spending increased 2.8 percent. Nonde-

Table I
Income and Earnings in Nebraska, SeasonallyAdjusted at Annual Rates
($ millions)

	1987:III	1987:IV	1988:I	1988:II	1988:III	1988:IV	1989:1	1989:II	% Change 1989:II versus 1988:II
Income									
Total Personal Income	21,473	24,304	23,281	24,214	23,017	24,166	24,976	25,007	3.3
Nonfarm	20,611	21,054	21,312	21,633	21,951	22,507	22,692	23,056	6.6
Farm	862	3,250	1,969	2,582	1,066	1,659	2,284	1,951	-24.4
Earnings by Industry**									
Ag. Services, Forestry, Fisheries	138	149	151	147	144	144	143	147	0.0
Mining	52	57	51	50	49	47	45	50	0.0
Construction	858	882	938	918	887	933	910	894	-2.6
Manufacturing	2,209	2,287	2,350	2,369	2,408	2,438	2,501	2,534	7.0
Nondurable	1,098	1,135	1,149	1,180	1,197	1,206	1,215	1,252	6.1
Durable	1,111	1,152	1,201	1,189	1,211	1,231	1,286	1,282	7.8
TCU***	1,623	1,614	1,613	1,608	1,641	1,602	1,670	1,686	4.9
Wholesale Trade	1,147	1,174	1,211	1,237	1,269	1,295	1,319	1,356	9.6
Retail Trade	1,512	1,512	1,545	1,579	1,606	1,636	1,683	1,693	7.2
FIRE****	1,174	1,211	1,189	1,205	1,220	1,241	1,232	1,241	3.0
Services	3,252	3,370	3,334	3,460	3,586	3,837	3,675	3,786	9.4
Government	2,943	2,996	3,046	3,077	3,046	3,148	3,214	3,268	6.2
Federal, Civilian	459	468	473	476	480	492	508	515	8.2
Military	400	400	406	402	401	403	417	416	3.5
State & Local	2,084	2,128	2,167	2,199	2,166	2,253	2,289	2,337	6.3

** Earnings is the sum of wages and alaries, other labor income, and income earned by sole proprietors
*** Transportation, communication, and utilities
**** Finance, insurance, and real estate
Source: Bureau of Economic Analysis, U.S. Department of Commerce

fense federal spending continued to exhibit a seesaw pattern, with a decrease of 38.7 percent in the advance third quarter numbers.

In net exports, we saw a peculiar phenomenon. Net exports had been stimulating the economy for several quarters. In the advance report, net exports were down $22.9 billion, all of which could be traced to an increase in imports. Advance figures for exports were unchanged. Export data are difficult to collect. On a monthly basis, carryover will average 20 percent, with wide variability. Initial monthly export figures should be viewed with healthy skepticism. Some variability will be eliminated by using quarterly data, as is done in the GNP accounts; however, preliminary export figures are subject to substantial revision.

Although the overall economy continues to expand, the industrial sector has been slowing for several months. Industrial production has grown 2.5 percent per year over the last decade and a half, with some recessions: a major downturn in 1975, a blip in 1980, and another major downturn in 1981-1982. The Industrial Production Index was flat prior to each of the recessions. The latest index figures show a decrease of 0.1 percent in September. Flatness in the index is not a guarantee of a forthcoming downturn--the index showed little growth from mid-1984 to the end of 1986, only to begin a rapid rise at the start of 1987. It is difficult to determine whether the current pause is a harbinger of a future downturn or a pause before further industrial expansion.

The Purchasing Managers Association index increased from the August level of 45.2 percent to 46.0 percent. Although an increase is preferred to a decrease, the association observes that index levels below 50 percent indicate a forthcoming decline. The membership of the Purchasing Managers Association consists of industrial concerns.

On the inflation front, there was good news and bad news in the September data releases. The good news was that the Consumer Price Index had a modest advance of only 0.2 percent in September. That gain followed a 0.0 percent increase the previous month. The Consumer Price Index now stands 4.3 percent above year ago levels (see Table III).

The bad news is the Producer Price Index. After decreasing for three months, the index increased 0.9 percent in September. The rise in the index is principally attributable to two items--increases in energy prices and auto prices. Energy prices accelerated 6.5 percent in September after falling 7.3 percent in August. The auto price index was up 3.8 percent--well beyond a normal seasonal September increase. The auto increase was mostly a list price advance, an inducement used by producers to sell 1989 models. The Producer Price Index overall stood 4.5 percent ahead of a year ago. When food and energy prices are removed from the index, the advance is a more moderate 4.3 percent, which matches the Consumer Price Index gain.

The 1989 model year for automobiles and light trucks was the fifth best on record. The model year runs from October to September. The 1989 figure stood at 15.1 million cars and light trucks. The previous model year totalled 15.4 million units. In order to create the sales levels seen in 1989, producers had to offer $8 billion in discounts. Those discounts averaged $900 per unit sold. With mid-October sales levels slumping, producers have cut output levels in the fourth quarter 10.4 percent. U.S. auto production in Japanese-owned and managed plants will advance 42 percent in the fourth quarter as their relatively new plants continue to expand their operation levels.

September housing starts dropped to a seven year low of 1.263 million units at annual rates. The housing starts were 5.2 percent below August levels. While short-term interest rates have fallen since March, mortgage rates climbed until the

Table II
Employment in Nebraska

	Revised August 1989	Preliminary September 1989	September % Change vs. Year Ago
Place of Work			
Nonfarm	710,839	715,211	3.2
Manufacturing	99,634	99,288	3.2
Durables	48,223	47,830	1.5
Nondurables	51,411	51,458	4.8
Mining	2,021	1,901	18.4
Construction	28,564	27,642	6.2
TCU*	47,879	48,110	5.9
Trade	183,783	182,546	2.2
Wholesale	52,709	52,562	4.2
Retail	131,074	129,984	1.4
FIRE**	49,355	49,065	1.9
Services	167,136	167,374	4.7
Government	132,467	139,285	1.4
Place of Residence			
Civilian Labor Force	825,064	811,012	-0.94
Unemployment Rate	3.1%	2.9%	

*Transportation, Communication, and Utilities
**Finance, Insurance, and Real Estate

Source: Nebraska Department of Labor

Table III
Price Indices

	September 1989	% Change vs. Year Ago	YTD % Change vs. Year Ago
Consumer Price Index - U* (1982-84 = 100)			
All Items	125.0	4.3	4.9
Commodities	117.3	3.8	4.9
Services	133.4	4.8	4.9
Producer Price Index (1982 = 100)			
Finished Goods	113.5	4.5	5.2
Intermediate Materials	112.4	3.4	5.3
Crude Materials	102.0	5.6	7.2
Ag Prices Received (1977 = 100)			
Nebraska	149	-3.2	8.0
Crops	126	-8.7	19.2
Livestock	164	-0.6	3.1
United States	143	-1.4	8.2
Crops	127	-8.6	11.3
Livestock	158	4.6	6.0

U* = All urban consumers
Source: U.S. Bureau of Labor Statistics

summer months. It may take some time for lower mortgage rates to stimulate housing demand.

Unemployment levels in the U.S. stood at 5.3 percent in September, a mild increase from 5.2 percent in August.

Nebraska Outlook

Table I presents the new personal income figures for the second quarter of 1989. Overall, total personal income is up 3.3 percent versus a year ago. There is a severe dichotomy between the farm and nonfarm sectors. Nonfarm personal income advanced 6.6 percent, while farm income was down 24.4 percent. This drop is not surprising, as the farm income component is volatile. Furthermore, lower agricultural prices (see Table III) have restrained farm income. In the nonfarm personal income sector, agricultural services, mining, and construction were weak. The remaining industries showed gains. Only two of those industries grew less than 4 percent: military and finance, insurance, and real estate (FIRE). Services and wholesale trade gained over 9 percent from year ago levels.

After extended growth since early 1987, retail sales showed signs of a slowdown. Figure II shows that both current dollar and inflation-adjusted retail sales fell in July. The changes in July were substantial. The July 1989 current dollar sales figures are below those of September 1988. Table V shows that July retail sales increased 4.4 percent versus a year ago, but on a year-to-date basis sales increased 8.0 percent through July. The recent fall in the retail trade numbers are being seen in some smaller cities, mostly those under 10,000 population. Those decreases reflect the drop in farm income displayed in Table I.

The labor force data, a count of persons who are actively working, was down 0.7 percent from a year ago in July. That decrease reflects a continuing trend. The job count continues to show advances. Preliminary figures for September show a gain of 3.2 percent from a year ago in nonfarm jobs (a count of positions.)

Table IV
City Business Indicators
July 1989 Percent Change from Year Ago

The State and Its Trading Centers	Employment (1)	Building Activity (2)
NEBRASKA	-0.7	4.8
Alliance	-0.2	-63.8
Beatrice	-0.6	-38.3
Bellevue	-1.7	-33.8
Blair	-1.7	60.8
Broken Bow	0.7	-79.8
Chadron	-0.2	712.5
Columbus	0.2	20.7
Fairbury	0.2	-83.5
Falls City	-0.5	-24.9
Fremont	-1.5	11.8
Grand Island	-1.1	-0.9
Hastings	-1.0	-28.9
Holdrege	0.0	883.5
Kearney	-0.2	-14.2
Lexington	1.1	460.2
Lincoln	-1.0	13.5
McCook	-0.3	-71.0
Nebraska City	-0.1	-9.3
Norfolk	-0.9	48.9
North Platte	-0.6	-39.6
Ogallala	-0.8	-33.0
Omaha	-1.7	2.5
Scottsbluff/Gering	-2.0	71.2
Seward	0.1	-19.3
Sidney	0.8	-46.5
South Sioux City	-2.8	135.6
York	-0.6	-10.8

(1)As a proxy for city employment, total employment (labor force basis) for the county in which a city is located is used

(2)Building activity is the value of building permits issued as a spread over an appropriate time period of construction. The U.S. Department of Commerce Composite Cost Index is used to adjust construction activity for price changes

Sources: Nebraska Department of Labor and reports from private and public agencies

Figure I
City Business Index
July 1989 Percent Change from Year Ago

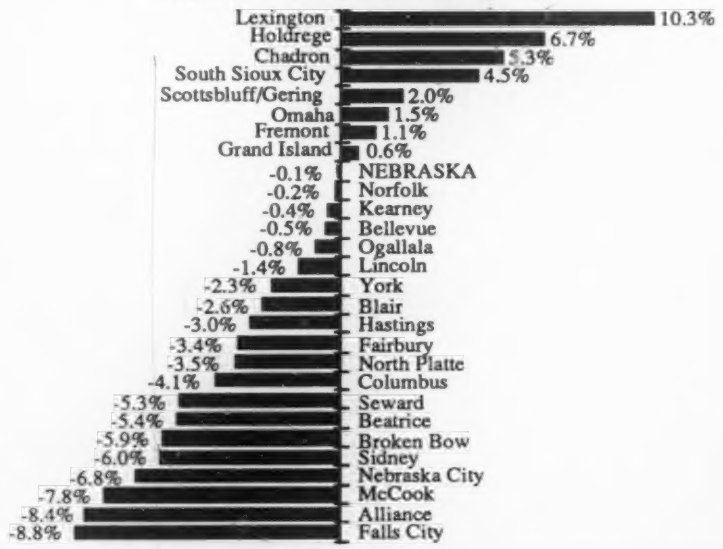
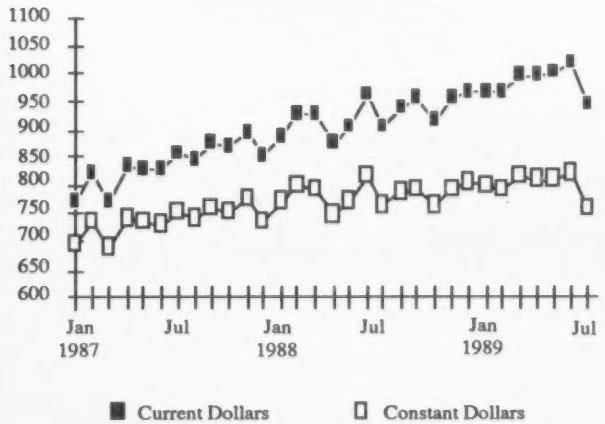


Table V
Net Taxable Retail Sales of Nebraska Regions and Cities

Region Number and City (1)	City Sales (2) July 1989 (000s)	City Sales (2) % Change vs. Year Ago	Region Sales (2) July 1989 (000s)	Region Sales (2) % Change vs. Year Ago	Region Sales (2) YTD % Change vs. Year Ago
NEBRASKA	$820,773	4.9	$947,529	4.4	8.0
1 Omaha	295,802	9.9	368,702	8.8	9.5
Bellevue	12,452	10.3	*	*	*
Blair	3,947	-4.9	*	*	*
2 Lincoln	107,999	1.2	127,235	1.2	4.7
3 South Sioux City	4,699	8.7	6,560	4.7	3.0
4 Nebraska City	3,203	-10.0	16,871	1.0	2.0
6 Fremont	15,344	7.8	26,997	2.2	5.0
West Point	2,301	13.8	*	*	*
7 Falls City	1,692	-12.2	7,857	-2.7	-0.8
8 Seward	3,583	-5.2	13,239	-1.7	2.5
9 York	5,877	1.4	14,506	0.6	11.2
10 Columbus	13,755	-7.0	24,065	-3.4	5.9
11 Norfolk	17,424	0.8	31,537	2.0	8.2
Wayne	2,203	-3.1	*	*	*
12 Grand Island	31,954	7.6	45,497	6.0	10.5
13 Hastings	14,792	2.9	24,265	2.3	7.7
14 Beatrice	6,566	-1.8	15,952	0.1	1.0
Fairbury	2,792	17.4	*	*	*
15 Kearney	18,659	5.9	26,501	4.3	10.7
16 Lexington	5,589	8.4	15,588	3.2	7.1
17 Holdrege	3,829	-5.3	7,811	-1.9	6.1
18 North Platte	15,590	3.1	19,659	3.7	4.4
19 Ogallala	6,578	8.4	12,409	7.2	12.3
20 McCook	7,109	0.8	10,029	-2.4	3.8
21 Sidney	3,797	-3.0	7,786	-1.5	2.8
Kimball	1,718	-13.2	*	*	*
22 Scottsbluff/Gering	16,973	5.6	23,916	5.5	11.3
23 Alliance	4,932	-3.0	12,817	-5.3	1.7
Chadron	2,516	-6.3	*	*	*
24 O'Neill	4,471	20.9	14,108	12.4	12.1
Valentine	2,540	5.0	*	*	*
25 Hartington	1,328	-1.3	7,591	0.4	2.2
26 Broken Bow	3,225	8.6	11,143	7.4	6.6

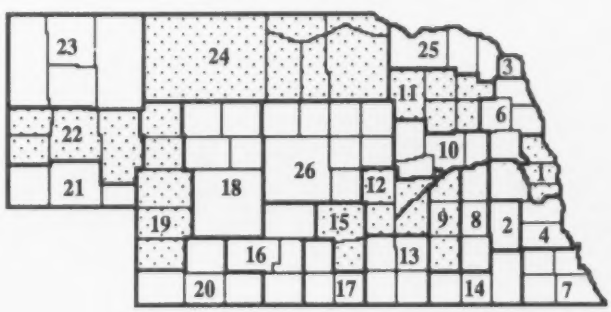
(1) See region map
(2) Sales on which sales taxes are collected by retailers located in the state. Region totals include motor vehicle sales
* Within an already designated region
Compiled from data provided by the Nebraska Department of Revenue

Figure II
Nebraska Net Taxable Retail Sales
(Seasonally Adjusted, $ Millions)



(1) The Consumer Price Index (1982-84 = 100) is used to deflate current dollars into constant dollars

Figure III
Region Sales Pattern
YTD as Percent Change from Year Ago



Shaded areas are those with sales gains above the state average. See Table V for corresponding regions and cities

Christmas Tree Production in Nebraska

There are more than 100 Christmas tree growers in Nebraska. Most of them are members of the Nebraska Christmas Tree Growers Association. These producers have about 50,000 trees for sale annually, although the number varies from year to year. During the holiday season, 20,000 to 25,000 trees are sold.

The total market for Christmas trees in Nebraska is estimated at 450,000 to 500,000 trees from all sources. Cut trees are imported from several states to meet this demand.

Nebraska growers plant about 150,000 trees per year. The age of these trees varies when harvested; however, most of the Christmas tree harvest occurs at seven years of age. This means that about one million potential Christmas trees are growing in the state.

A list of Nebraska growers is available at local County Extension Service and Natural Resource District offices.

Merlin W. Erickson

Business in Nebraska Readership Survey Now Being Conducted

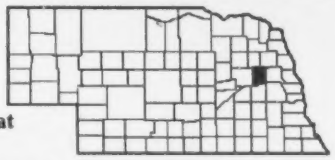
The Bureau of Business Research is conducting a survey of *Business in Nebraska* readers to determine what kinds of articles and information to include in future issues. The survey form was contained in the October edition.

Our thanks to all of you who completed questionnaires. Your comments were useful and helped us to gain a better perspective of what material you need.

For the rest of you, please complete the survey and return it as soon as possible--we hope to compile the responses by the end of the year . . . or give us a call--we're always happy to hear your thoughts about ways to better serve the people of Nebraska.

County of the Month

Colfax



Schuyler--County Seat

Size of county: 415 square miles, ranks 86th in the state
Population: 9,200 (estimated) in 1988, a change of -7.2 percent from 1980
Median age: 34.0 years in Colfax County, 29.7 years in Nebraska in 1980
Per capita personal income: $13,048 in 1987, ranks 70th in the state
Net taxable retail sales ($000): $39,533 in 1988, a change of +12.3 percent from 1987; $23,213 during January-July 1989, a change of +3.8 percent from the same period one year ago
Number of business and service establishments: 251 in 1986; 66.9 percent had less than five employees
Unemployment rate: 2.7 percent in Colfax County, 3.6 percent in Nebraska for 1988
Nonfarm employment (1988):

	State	Colfax County
Wage & salary workers	688,146	3,469
	(percent of total)	
Manufacturing	13.8%	40.9%
Construction and Mining	3.8	3.5
TCU	6.5	2.3
Retail Trade	18.5	14.3
Wholesale Trade	7.3	8.0
FIRE	7.0	3.1
Services	23.0	12.6
Government	20.1	15.3
Total	100.0%	100.0%

Agriculture:

Number of farms: 778 in 1987, 779 in 1982
Average farm size: 298 acres in 1987
Market value of farm products sold: $127.8 million in 1987 ($164,230 average per farm)

Sources: U.S. Bureau of the Census, U.S. Bureau of Economic Analysis, Nebraska Department of Labor, Nebraska Department of Revenue

Merlin W. Erickson

Business in Nebraska

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